

REPORT BY THE
AUDITOR GENERAL
OF CALIFORNIA

**STATUS REPORT:
THE STATE LOAN TO THE ALAMEDA COUNTY
SUPERINTENDENT OF SCHOOLS**

REPORT BY THE
OFFICE OF THE AUDITOR GENERAL
TO THE
JOINT LEGISLATIVE AUDIT COMMITTEE

F-438

STATUS REPORT: THE STATE LOAN TO THE
ALAMEDA COUNTY SUPERINTENDENT OF SCHOOLS

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F-438

Honorable Art Agnos, Chairman
Members, Joint Legislative
Audit Committee
State Capitol, Room 3151
Sacramento, California 95814

Dear Mr. Chairman and Members:

The Office of the Auditor General presents its report concerning the status of the Alameda County Superintendent of Schools' (ACSS) operations and the Superintendent of Public Instruction's monitoring and review of the ACSS in accordance with the provisions of Chapter 46, Statutes of 1984. We found that although the ACSS has made progress toward its goal of financial stability, the Superintendent of Public Instruction should continue his monitoring activities.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Thomas W. Hayes".
THOMAS W. HAYES
Auditor General

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SUMMARY

The Alameda County Superintendent of Schools (ACSS) has made progress toward its goal of financial stability. Although the ACSS ended 1983-84 with an estimated \$1.6 million deficit fund balance (excluding the \$5.5 million liability for the state loan), the ACSS' budget for 1984-85 proposes repaying \$4.45 million, including accrued interest to date, of the \$5.5 million state loan. This budget also projects that the ACSS will end the year with a fund balance of \$537,000, which has been reserved for contingencies. The ACSS estimates that it will owe the State approximately \$1.25 million of loan principal on June 30, 1985. Interest will continue to accrue on the outstanding portion of the loan until the loan is completely repaid in four years.

It is too soon to predict when the ACSS will be able to reach its goal of financial stability. To ensure that the ACSS' fiscal problems do not recur, the Superintendent of Public Instruction should continue monitoring the ACSS' operations to ensure that the ACSS exercises fiscal restraint.

The Cash Position of the ACSS

Because of the financial crisis at the ACSS in January 1984, the Alameda County Treasurer refused to permit the ACSS to continue a cash deficit at the County Treasury. The ACSS' cash flow projection for 1984-85 shows a deficit cash balance as of the last day in April 1985, the date on which the Alameda County Treasurer may no longer advance funds to the ACSS. Should the ACSS have a deficit cash balance in April 1985, the Alameda County Treasurer may register warrants if the ACSS is unable to obtain outside financing. The ACSS has the option of temporarily delaying disbursements, to the extent that such action is possible.

The ACSS' Budget for 1984-85

On September 4, 1984, the Alameda County Board of Education approved the 1984-85 budget submitted by the ACSS. In preparing this budget, the ACSS made assumptions that we believe could significantly affect the accuracy of the budget. Three of these assumptions dealing with the manner in which the loan from the State is repaid are of uncertain reliability, and they are based upon interpretations of Chapter 46, Statutes of 1984, made by representatives of the Superintendent of Public Instruction acting in their capacity as administrators. If these assumptions are valid, the ACSS will have approximately \$755,000 more than it originally anticipated for 1984-85 operations, and it will be relieved of approximately \$429,000 in interest expense that it would have had to pay in the future.

In its attempt to achieve financial stability and to present a balanced budget for 1984-85 with a reserve for contingencies, the ACSS has made major changes in its operations. ACSS management significantly reduced staff, used grant money to fund positions that had previously been funded by the operating budget, increased income by charging additional fees for services that were previously provided at lower or no cost to school districts, and increased income by leasing out additional space in the ACSS' building. Additionally, ACSS management have attempted to build flexibility into the budget by providing for the opportunity to defer certain rental expenses until subsequent years.

Effect of Budget Reductions on Services Provided

Despite staff and operating expense reductions, ACSS management anticipate being able to continue to provide many of the services provided in the past. The ACSS provides instructional services to students enrolled in the county's Juvenile Court School and Special Centers as well as support services to school districts within

Alameda County. The ACSS expects to make only minimal changes in the instructional services. However, the ACSS expects certain reductions, delays, and eliminations in support services provided to school districts as a result of the planned reductions. Additionally, the ACSS will continue to provide data processing services to the school districts but at increased cost. However, inadequate communication from the ACSS to the school districts regarding its intentions to provide payroll services past 1984-85 may have resulted in some districts' incurring unnecessary additional costs.

INTRODUCTION

In February 1984, the Office of the Auditor General issued its report entitled "The Alameda County Superintendent of Schools Needs an Emergency Loan of \$5 Million" (Report F-385). The report described the fiscal condition of the ACSS and the causes of that condition as it existed in January 1984. The report recommended that pending legislation be amended to provide emergency funds to the Alameda County Superintendent of Schools (ACSS). The report also recommended and the subsequent legislation requires that the Office of the Auditor General report annually to the Legislature on the status of the ACSS' operations and on the Superintendent of Public Instruction's monitoring and review of the ACSS, as long as the loan is outstanding.

The Alameda County Superintendent of Schools operates in accordance with policies approved by the seven-member Alameda County Board of Education. The superintendent of schools and the board members are elected officials serving four-year terms. The ACSS operates development centers for handicapped minors and a juvenile court school, and it provides educational services to the 19 school districts within Alameda County and to other educational agencies. Additionally, it provides data processing services to school districts in Alameda and other counties. The ACSS also operates such federal projects as the Special Education program and the Comprehensive

Employment Training Act program. Until fiscal year 1984-85, the ACSS operated a countywide transportation program for handicapped students.*

The ACSS' Fiscal Problems

In January 1984, the Alameda County Treasurer registered the warrants that were issued from the ACSS' account as a result of the ACSS' continuing deficit balance at the County Treasury. Without outside financing, the ACSS' deficit was expected to reach at least \$5.0 million by June 30, 1984.

The ACSS' deficit arose because of a number of poor management decisions that began in 1981 and continued through January 1984. These decisions involved the ACSS' depleting its financial resources to acquire a new office building and undertaking a countywide program to transport handicapped students despite inadequate financial reserves. The ACSS compounded its problems because it failed to follow its annual operating budgets. In addition, the ACSS knowingly understated projected expenditures and overstated projected revenues in the 1983-84 budget that it submitted to the State Department of Education and the Alameda County Board of Education.

*Unless otherwise noted, all references to years in this report are to fiscal years.

The State's Emergency Loan to the ACSS

In March 1984, the Legislature enacted emergency legislation (Chapter 46, Statutes of 1984) to relieve the ACSS' immediate cash crisis. This legislation provided a \$5.5 million loan to the ACSS, and imposed special reporting and accountability requirements as conditions of the ACSS' accepting the loan.

Chapter 46, Statutes of 1984, required the ACSS to provide certain reports and to be accountable to the Superintendent of Public Instruction (State Department of Education). In addition, the legislation directed the Superintendent of Public Instruction to appoint a bonded trustee to monitor and review the ACSS' compliance with the requirements of Chapter 46, Statutes of 1984, and it directed the State Controller to perform the annual financial and compliance audits of the ACSS while the loan is outstanding. Chapter 46, Statutes of 1984, also required the ACSS to provide written notification to the school districts within Alameda County that the ACSS would discontinue special transportation services for district students and provided an appropriation of \$5.3 million so that school districts could initiate their own special transportation programs. Finally, the legislation specified the manner in which the ACSS is to repay its loan over a five-year period.

The ACSS received the full amount of the loan authorized by Chapter 46, Statutes of 1984: \$4.9 million in March 1984 and the

remaining \$.6 million in May 1984. In March, the Superintendent of Public Instruction appointed a trustee to monitor and review the ACSS' operations. The trustee notified school districts in April of the ACSS' intent to discontinue operating the special transportation program for district students.

The Alameda County Superintendent of Schools and the Assistant Superintendent for Business Services resigned their positions, effective June 30, 1984. The new Alameda County Superintendent of Schools assumed his duties on July 2, 1984. In August 1984, the ACSS hired a new Assistant Superintendent for Business Services, who assumed his duties full time in September 1984.

SCOPE AND METHODOLOGY

We reviewed the operations of the ACSS and the Superintendent of Public Instruction's monitoring and review of those operations. We did not audit any of the accounts or reports referred to in this report; Chapter 46, Statutes of 1984, designates the State Controller as the agency responsible for conducting the financial and compliance audit of the ACSS for 1983-84. In addition, we did not evaluate the propriety of the distribution of staff reductions, nor did we evaluate the effectiveness of the remaining services that the ACSS provides.

We assessed the ACSS' and the Superintendent of Public Instruction's compliance with the requirements of the emergency

legislation. We also examined the cash flow projection that the ACSS submitted to the Alameda County Treasurer and reviewed the projection's underlying assumptions. We reviewed the reasonableness of the budget that the ACSS submitted to the County Board of Education for 1984-85, but we did not examine the beginning balance used in preparing the budget because this information was not available at the time of our review. In addition, we examined agreements for the services of the trustee and the consultant, and we examined the progress reports detailing the activities of both. Finally, we reviewed the special transportation data reports for 1981-82 and 1982-83 prepared by the ACSS.

During the course of our review, we met with the Alameda County Treasurer, members of the Alameda County Board of Education, and representatives of the Superintendent of Public Instruction, including the trustee. We also interviewed the newly appointed county superintendent of schools, the consultant to the trustee and county superintendent of schools, staff at the ACSS, and superintendents from 9 of the 19 school districts in Alameda County.

It was not within the scope of this review to conduct an examination in accordance with generally accepted auditing standards that would enable us to express an opinion on any of the financial information referred to in this report.

ANALYSIS

THE ALAMEDA COUNTY SUPERINTENDENT OF SCHOOLS HAS MADE PROGRESS TOWARD ITS GOAL OF FINANCIAL STABILITY

Although the Alameda County Superintendent of Schools (ACSS) ended 1983-84 with an estimated \$1.6 million deficit fund balance (excluding the \$5.5 million liability for the state loan), the ACSS presented a budget for 1984-85 that proposes repaying \$4.45 million of the state loan, including accrued interest to date, as well as ending the year with a fund balance of \$537,000. This fund balance has been reserved for contingencies.

Responsibilities of the Superintendent of Public Instruction and the ACSS

Chapter 46, Statutes of 1984, requires the Superintendent of Public Instruction, through a trustee, to assume monitoring responsibilities and the ACSS to perform certain actions as a condition of the ACSS' receiving a loan from the State. The responsibilities defined by Chapter 46, Statutes of 1984, apply to the entire period during which the loan is outstanding.

Chapter 46, Statutes of 1984, requires the Superintendent of Public Instruction, through a trustee, to monitor the ACSS while the loan is outstanding. The legislation requires the Superintendent of Public Instruction to appoint a bonded trustee with recognized

expertise in management and finance. This trustee is to serve until the loan is repaid, unless the Superintendent of Public Instruction, in consultation with the Auditor General, determines that the trustee's services are necessary for a shorter period of time. The Superintendent of Public Instruction is to establish the trustee's salary and the terms and conditions of the trustee's employment, and the ACSS is to bear the cost of employing the trustee. On March 27, 1984, the Superintendent of Public Instruction appointed a trustee to perform the functions set forth in Chapter 46, Statutes of 1984, for an undetermined period. The Superintendent of Public Instruction agreed to compensate the trustee at a rate of \$4,120 per month, on the basis of two-thirds of full-time employment.

As a condition of the ACSS' receiving the loan authorized in Chapter 46, Statutes of 1984, the Legislature required three actions by the ACSS. First, the ACSS was to provide written notification to the school districts within Alameda County that the ACSS would no longer provide countywide transportation services for the handicapped beginning on July 1, 1984. The trustee did this in April 1984. Second, the ACSS was to agree to pay at least one-half of the difference between the ACSS' transportation entitlement for 1984-85, which is based on services provided in 1983-84, and the actual amount that the ACSS received from the State in lieu of that entitlement. The ACSS' budget for 1984-85 reflects this provision. Finally, the ACSS was required to submit a number of reports, including its 1984-85 budget, to the trustee for his review. A discussion of these reports and the trustee's review of them begins on page 9.

A major responsibility of the trustee, as defined by Chapter 46, Statutes of 1984, is to monitor the development of the ACSS' annual budget while the loan is outstanding and to approve or reject the budget once it is developed. Because of conditions existing at the ACSS, the trustee determined that it was necessary to expand his duties beyond that of the oversight role described in Chapter 46, Statutes of 1984, and take a more active role in ACSS management. According to the trustee, upon assuming his duties at the ACSS, he immediately became concerned about the inconsistency of financial reports and projections, the laxity of expenditure controls, and the apparent duplication of effort existing in the current organizational structure.

On April 2, 1984, six days after assuming his responsibilities at the ACSS, the trustee determined that it was necessary to establish a freeze on all but the most essential expenditures. To implement this freeze, the trustee assumed responsibility for approving all warrants and purchase orders. (This responsibility was subsequently returned to the county after the new county superintendent of schools was appointed.) In addition, the trustee decided that it was "essential that a specialist in school finance, accounting, and budgeting be employed immediately."

On April 13, 1984, the trustee, with the approval of representatives of the Superintendent of Public Instruction, arranged for a consultant to be hired to assist him in his duties. The original

scope of the consultant's employment was to validate the ACSS' financial data for 1983-84, validate projected income and program costs for the 1984-85 budget, and conduct a workflow analysis of the ACSS. The consultant completed a workflow analysis that was used to aid management in deciding where to make staff reductions. He also verified enough 1983-84 data to estimate a beginning balance for the 1984-85 budget. However, the trustee discovered that budget development and other financial activities were not progressing satisfactorily because of the absence of key personnel as well as other problems. Consequently, the trustee significantly expanded the consultant's responsibilities.

Instead of merely validating the ACSS' 1984-85 budget, the consultant was asked to develop the budget. The consultant was assigned responsibility for developing cash flow projections for 1984-85, validating the special transportation data reports, and advising staff within the Business Services Division. In effect, the consultant temporarily filled the vacant Assistant Superintendent for Business Services position. (A new Assistant Superintendent for Business Services was hired in August to begin full-time employment in September.) ACSS management anticipate that the consultant's services will be required on a less frequent basis through September and October. The total cost of the consultant's contract, including staff, through September 6, 1984, was \$64,500.

In addition to monitoring and developing the budget, the trustee was also required to review an analysis of Alameda County's special transportation program using the cost-effectiveness criteria contained in Section 56774 of the California Education Code. Chapter 46, Statutes of 1984, required this analysis. However, the trustee was not able to conduct this review because the ACSS did not prepare the analysis. The trustee subsequently explained that there was no feasible means by which the ACSS could comply with the requirements of the legislation. He stated that, because of its financial problems, the ACSS could not afford to contract for the analysis and did not have the personnel to complete the analysis itself. He further stated that the school districts did not have the data available to meet the April 1 deadline for the analysis.

Chapter 46, Statutes of 1984, further requires that, upon recommendation by the trustee, the Superintendent of Public Instruction is to report to the Legislature any failure of the ACSS to comply with the requirements of the law and may penalize the ACSS for late or unacceptable reports. In addition, upon favorable recommendation by the trustee at the completion of his review, the Superintendent of Public Instruction is required to certify to the Director of Finance that the ACSS has taken action to correct its financial problems. The Superintendent of Public Instruction did not report to the Legislature the ACSS' failure to prepare an analysis of the county's special transportation program; however, the trustee did not recommend to the Superintendent of Public Instruction that any penalties be imposed for

the reasons described above. The trustee consistently informed representatives of the Superintendent of Public Instruction of his activities and the ACSS' progress in correcting its financial problems throughout the period we examined.

Finally, the trustee is required to review quarterly reports comparing actual receipts and expenditures to the budgeted amounts by detailed line item. He is also to approve in writing any deviation that ACSS makes from its detailed operating budget. Because the opportunity to perform these duties has not yet occurred, we cannot comment on this phase of the trustee's performance.

We interviewed various persons whom the trustee has dealt with in the course of his duties. We spoke with 9 of the 19 school district superintendents; the 4 district superintendents who commented on the trustee expressed satisfaction with his performance. The three County Board of Education members we interviewed stated that the trustee kept them well informed; they were especially appreciative of the manner in which he explained the proposed budget to them. The representative of the Superintendent of Public Instruction to whom the trustee reports commented that he is pleased with the work that the trustee has performed and believes that he was also kept well informed.

The Cash Position of the ACSS

In January 1984, the Alameda County Treasurer refused to permit the ACSS to continue maintaining a cash deficit at the Treasury. The loan from the State was the primary reason that the ACSS ended the 1983-84 fiscal year with a positive cash balance at the Alameda County Treasury. To maintain this positive cash balance into the 1984-85 fiscal year, the ACSS requested that the County Treasurer advance funds to the ACSS' account. In accordance with the California Education Code Section 42620, the County Treasurer advanced 85 percent of the ACSS' anticipated revenues for 1984-85. Article XVI, Section 6, of the State Constitution, provides that advances shall not be made after the last Monday in April of the current fiscal year and requires repayment of the advances from revenues received before such revenues are used to meet any other obligation.

As part of its assurances to repay the advance, the ACSS submitted to the County Treasurer a projection of its cash flow for 1984-85. This document projects a deficit cash balance as of April 30, 1985. Our review of the data and assumptions underlying the cash flow projection suggests that the predicted April deficit may occur.

Should the April 1985 deficit exist, the County Treasurer may register warrants unless the ACSS is able to obtain outside financing. The ACSS has the additional option of temporarily delaying

disbursements, to the extent that this is possible. The ACSS' cash flow projection anticipates a positive cash balance on June 30, 1985. On July 1, 1985, the County Treasurer can advance 85 percent of the next year's anticipated revenues.

The ACSS' Budget for 1984-85

On September 4, 1984, the Alameda County Board of Education approved the 1984-85 budget submitted by the ACSS. The ACSS' budget included an estimated beginning deficit fund balance of \$1.6 million, which does not include the \$5.5 million liability owed to the State on the loan. The budget anticipates total income of \$16.3 million and expenditures of \$9.7 million; thus, income exceeds expenditures by \$6.6 million. Of the \$6.6 million, \$4.45 million will be applied to the \$5.5 million loan liability, and \$1.6 million will be used to eliminate the beginning deficit fund balance; this leaves an ending fund balance of \$537,000, which has been reserved for contingencies. The budget reflects only obligations of 1984-85; therefore, it does not include the \$1.25 million liability owed to the State for the loan at June 30, 1985. Table 1 on the next page presents a summary of the budget.

TABLE 1

BUDGET SUMMARY
ALAMEDA COUNTY SUPERINTENDENT OF SCHOOLS
FISCAL YEAR 1984-85

Income	
Federal	\$ 949,947
State	11,268,110
Local	<u>4,070,733</u>
Total Income	\$16,288,790
Expenditures	
Certificated salaries	\$ 1,876,156
Classified salaries	2,539,170
Employee benefits	1,234,445
Books and supplies	440,575
Services and other operating expenditures	2,134,166
Capital outlay	<u>1,475,399</u>
Total Expenditures	<u>9,699,911</u>
Income over Expenditures	\$ 6,588,879
Less:	
Loan Repayment	4,450,315
Deficit Balance at July 1, 1984	<u>1,601,537</u>
Fund Balance at June 30, 1985 (Reserved for Contingencies)	<u>\$ 537,027</u>

*This reserve equals 3.8 percent of the anticipated total of expenditures and loan repayment.

We have a number of concerns about the ACSS' budget. First, the accuracy of the budget is subject to the accuracy of the beginning balance used in preparing the budget. We were not able to examine the beginning balance because this information was not available at the time of our review; the State Controller will audit this balance as part of his financial audit for 1983-84. Second, the \$537,000 may not be a realistic estimate of what the ACSS will be able to reserve for contingencies. For example, the Alameda County Board of Education approved the budget with the \$537,000 reserve on September 4, 1984; on the next day, the trustee authorized the disbursement of \$84,500 in funds from this contingency reserve. Third, the trustee and the consultant to the trustee and county superintendent of schools, who developed the budget, have stated that the ACSS must continue to exercise fiscal restraint because of the tentative nature of certain estimates and assumptions included in the budget.

Furthermore, in preparing its budget, the ACSS made a number of assumptions that we believe could significantly affect the accuracy of the budget. These assumptions are as follows:

1. The repayment of the loan principal consisting of 92.08 percent of the reimbursement for 1983-84 special education transportation costs would be based on the amount that the ACSS received in 1983-84 not the amount to which it was entitled.
2. The loan would not begin to accrue interest until July 1, 1984.
3. The repayment of the loan principal consisting of 92.08 percent of the reimbursement for 1983-84 special education transportation costs would be considered received July 1, 1984.

4. The budget contains no allowances for salary or benefit increases for which specific provisions have not already been made.
5. The program managers' estimates of operating expenditures are reasonably accurate.
6. The 16 school districts and 2 community colleges currently participating in the ACSS' payroll system will participate for at least nine months during 1984-85, thus ensuring that the ACSS will receive a certain level of income for providing payroll services.
7. The state transportation apportionment will not be reduced by more than 10 percent as a result of the State's not having sufficient funds appropriated to reimburse allowable costs.
8. All rental and lease, data processing, audiovisual, and other income agreements will be signed. (At the time of our review, several had not been signed.)
9. The ACSS will receive anticipated federal and state grant funds. (At the time of our review, the ACSS had not received official notification of award for certain grants.)
10. Income resulting from the sale of publications, the rental of films to nonpublic schools, and other items for which there are no contracts will be approximately the same as in 1983-84.

We are particularly concerned about three of the assumptions relating to the loan from the State (Assumptions 1, 2, and 3). These assumptions were based upon interpretations of Chapter 46, Statutes of 1984, made by representatives of the Superintendent of Public Instruction acting in their capacity as administrators. Each interpretation has a material effect upon the ACSS' budget. If the three assumptions are valid, the ACSS will have approximately \$755,000 more than it originally anticipated for 1984-85, and it will be relieved of approximately \$429,000 in interest expense that it would have had to pay in the future. Under these assumptions, we estimate that the ACSS will owe the State approximately \$1.25 million of loan

principal at the end of 1984-85. Interest will continue to accrue on the outstanding portion of the loan until the loan is completely repaid in four years.

The first assumption regarding the loan relates to the manner in which the major payment in 1984-85 is computed. The California Education Code limits transportation reimbursements received in the current fiscal year to the transportation allowance received in the previous year, plus any increase provided by the Legislature. In 1983-84, the State did not have sufficient funds appropriated to reimburse the total allowable costs incurred in 1982-83 for the Special Education Transportation program; consequently, the program was "deficited." The State subsequently decided to fund the deficit, and the ACSS will receive the balance of its 1983-84 funding in 1984-85. According to Chapter 46, Statutes of 1984, the ACSS will repay the major portion of its loan from the State by having its transportation apportionment reduced by 92.08 percent. (The ACSS will be reimbursed in 1984-85 for the costs of providing countywide transportation services for the handicapped in 1983-84; because this program was returned to school districts on July 1, 1984, the ACSS would not need this money for program costs.) However, in computing its loan repayment, the ACSS assumed that the State would base the reduction on the 1983-84 transportation allowance received before the deficit was funded (\$4.28 million) rather than on the allowance received after the deficit was funded (\$5.10 million), the amount to which it was entitled. This assumption allows the ACSS to use approximately

\$755,000 (\$.82 million multiplied by 92.08 percent) more for its operations in 1984-85 and results in a larger loan balance to be repaid in the subsequent four years.

The second and third assumptions regarding the loan relate to the manner in which the interest expense on the loan is computed. Because the ACSS assumes that the loan will not begin accruing interest until July 1, 1984, the ACSS assumes it will not have to pay approximately \$144,000 in interest expense for the period between the date the loan was issued and July 1, 1984. Moreover, the ACSS assumes the State will not collect an additional \$285,000 in estimated interest expense because the effective date for repaying the principal is assumed to be July 1, 1984, instead of the date regularly used by the Superintendent of Public Instruction when administering state loans to school districts.

We requested opinions from the Legislative Counsel regarding the Superintendent of Public Instruction's authority to make assumptions relating to the manner in which the interest expense on the loan is computed. Legislative Counsel concluded that Chapter 46, Statutes of 1984, does not authorize the Superintendent of Public Instruction to exempt the ACSS from paying interest for 1983-84 (Assumption 2). It is the Legislative Counsel's opinion that "Chapter 46, Statutes of 1984, and California Education Code Section 41324 both fix the date of disbursement of the funds as the date for the accrual of interest to commence." Regarding Assumption 3,

the Legislative Counsel concludes that the better interpretation of Chapter 46, Statutes of 1984, is that the 1984-85 apportionments to the ACSS should be reduced at the time these apportionments are made, as opposed to several months prior to that time. However, the Legislative Counsel states that an agency's interpretation of a statute that it is responsible for enforcing will be given "great weight" by the courts unless that interpretation is "clearly erroneous." It is the Legislative Counsel's opinion that "a court, if faced with this issue, might not find the Superintendent of Public Instruction clearly erroneous in interpreting Chapter 46, Statutes of 1984, as authorizing the reduction on July 1, 1984."

Ultimately, the validity of the three interpretations pertaining to the loan may be resolved by the courts.

Budget Reductions

The ACSS has made major changes in its operations in its attempt to achieve financial stability. To present a balanced budget with a reserve for 1984-85, ACSS management significantly reduced staff, used grant money to fund positions that had previously been funded by the operating budget, increased income by charging additional fees for services that were previously provided at lower or no cost to school districts, and increased income by leasing out additional space in the ACSS' building. Additionally, ACSS management have attempted to build flexibility into the budget by providing for the opportunity to defer certain rental expenses until subsequent years.

The ACSS' budget for 1984-85 reflects a significant reduction in staffing level from previous years. On July 1, 1983, the ACSS employed 272 staff. Approximately 25 positions were vacated between July 1, 1983, and August 1, 1984; the ACSS does not currently plan to fill these positions during 1984-85. Approximately 21 of the 25 positions were classified (noncertificated) personnel. Furthermore, because of the need for budget reductions, the ACSS laid off 37 additional classified employees, effective June 30, and July 31, 1984. The ACSS estimates that the savings in salaries and benefits resulting from these reductions total \$1.6 million. The Associate Superintendent for Educational Services decided which positions should be eliminated based upon information from various program managers, district superintendents, and the trustee appointed by the Superintendent of Public Instruction. The trustee based his recommendations on a workflow analysis that the consultant prepared.

The ACSS realized further budget reductions by using available grant money to fund positions that previously had been funded by the county school services fund. ACSS management reported that six positions, representing budgeted expenses of \$187,000, were transferred from the county school services budget to projects funded by grants. The trustee anticipates that the ACSS will be able to fund even more positions in this manner if pending applications for grant money are approved.

The ACSS has significantly increased its anticipated income by charging school districts for services that it had previously provided at lower or no cost. The ACSS provides a variety of payroll, data processing, audiovisual repair, and film and video cassette rental services to school districts. In previous years, the ACSS provided payroll services at no charge to the school districts, but the ACSS did charge fees for data processing, audiovisual repair, and film and video cassette rental. However, according to ACSS staff, those fees did not cover all of the ACSS' costs.

By charging fees for payroll services, the ACSS estimates that it will earn an additional \$486,000. Furthermore, the data processing manager states that a 20 percent increase in charges for data processing services will increase income for 1984-85 by approximately \$38,000. Finally, by raising fees for audiovisual repair and film and video cassette rental, the ACSS will increase income by approximately \$32,000. Total increased income to the ACSS in 1984-85 as a result of the fee changes will be approximately \$556,000.

The ACSS also anticipates increased income from leasing out additional space in its building. In our February report, we stated that the ACSS hoped to lease out approximately 13,230 square feet at \$1.40 per square foot. During our fieldwork in August, we examined lease agreements for 7,876 square feet. This space was leased at a rate of approximately \$1.15 per square foot, but not all tenants will be in the building for the entire year. The lease agreements will

generate approximately \$91,000 in additional income for 1984-85. As discussed on page 17, not all of the agreements had been signed at the time of our review.

Finally, the ACSS has attempted to build flexibility into its budget by renegotiating an agreement through which the ACSS leases space from Alameda County for its Juvenile Court School. The agreement originally called for rent of \$174,000 per year. However, the ACSS worked out an arrangement with the county so that the ACSS is only obligated to pay approximately \$43,000 during 1984-85; a minimal amount of interest will accrue on the balance until it is paid.

Effect of Budget Reductions
on Services Provided

County superintendents of schools are directed by the California Education Code to perform certain services for school districts. The ACSS also provides services in addition to those required. ACSS management state that despite the significant reductions in staff, the ACSS will be able to provide all mandated services as well as many nonmandated services. According to the Associate Superintendent for Educational Services, budget reductions will primarily result in reduced levels of services rather than in the elimination of services.

The ACSS provides instructional services to students enrolled in Alameda County's Juvenile Court School and Special Centers as well

as support services to school districts within the county. The ACSS expects only minimal changes in instructional services, but it expects certain reductions, delays, and eliminations in support services provided to school districts as a result of the planned budget reductions.

The ACSS provides instructional services in two areas: the Juvenile Court School, where instruction is provided to youths who are wards of the Juvenile Court, and the Special Centers, where individualized programs are provided to severely handicapped pupils. Three certificated positions in the Juvenile Court School were vacated during 1983-84 and not filled. The Associate Superintendent for Educational Services stated that the ACSS did not further reduce staff in these two areas because the programs were already operating at a minimum staff level. He added, however, that the two programs will be expected to operate within their budgets.

The manager of Educational Development Services anticipates that budget reductions will reduce and delay some services provided to school districts and eliminate certain other coordination activities. The function of the Educational Development Services has been to help schools improve by providing staff development programs to school districts and to coordinate business, community, and education partnerships. The manager now anticipates that the reduction in services will include reduced responses to requests from the school districts and reduced administrative training programs conducted by

staff. The manager also expects delays in responses to individual and school requests for resources and information. Finally, the manager predicts that certain coordinating activities, such as coordination of educational organizations and countywide student contests, will be eliminated.

ACSS management also expect reductions and delays in some services in Educational Technology Services. This unit provides learning materials, such as films and video cassettes, to school districts and nonpublic schools, and it maintains a professional library, a computer unit, a television studio to produce video tapes, and an audiovisual repair shop. As discussed on page 22, the ACSS will continue to provide for audiovisual repair and usage services, but the cost of these services will be increased. The manager of Educational Technology Services estimates that reductions will result in limited response to school districts' inquiries about textbook and computer use. The reductions will also mean that the unit will be able to fill only half of the orders for publications and acquire only about half as many new video cassette titles. The manager further expects delays in filling printing requests and repairing equipment and microcomputers. The manager stated that no new films or professional books would be purchased during the year and that no educational research will be conducted for staff or visitors.

Budget reductions also resulted in significant changes in credentialing services provided by the ACSS. Two of the three

positions in the Credentials Unit were eliminated. Consequently, this unit will now process only emergency credential applications for staff, and it will no longer act as liaison between school districts and the Commission on Teacher Credentialing.

As discussed on page 22, the ACSS will continue to provide data processing services to the school districts but under a new fee policy. The ACSS previously provided payroll services at no cost to the school districts; the ACSS now charges \$3 to process each warrant up to a maximum of \$27 a year. The ACSS has also raised fees for other data processing services by approximately 20 percent.

The school districts within Alameda County have mixed reactions to the changes in support services. As part of our review, we interviewed 9 of the 19 district superintendents to elicit their comments on the changes. Three district superintendents indicated that they recognized the need for the changes. Two district superintendents expressed hope that the ACSS would reinstate certain services when fiscal conditions improved. Two district superintendents stated that they especially missed the credentialing services, and two other district superintendents stated that it was too early to conclude on the effect of the changes in services.

All eight district superintendents whom we interviewed whose districts currently participate in the ACSS' payroll system are planning to discontinue payroll services at the end of 1984-85 or

earlier. Several of the districts' decisions to discontinue contracting for payroll services with the ACSS appear to result from the ACSS' failure to communicate its intentions adequately about whether it would continue to provide services. Two district superintendents informed us in August that they understood that the ACSS intended to discontinue payroll services after 1984-85; however, ACSS management stated in August that they definitely plan to provide payroll services after 1984-85. In fact, they are currently negotiating to purchase new computer equipment to provide payroll and other data processing services more effectively.

This confusion appears to result from the earlier statements that ACSS management made. A May 30, 1984, letter from the Associate Superintendent for Educational Services (then Acting Superintendent) informed district superintendents that all data processing services would be terminated on July 1, 1984, unless the districts chose to purchase the services at cost, in which case the services would be available through June 30, 1985. Although the trustee stated that ACSS management verbally informed district superintendents of their revised intentions to provide services beyond 1984-85, ACSS management issued no written communication regarding this matter until August 7, 1984. At that time, the new Alameda County Superintendent of Schools informed the district superintendents that the ACSS would know within 60 days whether it could continue to provide payroll services to the school districts.

Four of the eight superintendents of school districts we interviewed that currently participate in the payroll program stated that they have already purchased computer equipment for processing payroll; only one of the four reported making these plans before the ACSS encountered financial problems. The three who had not planned to process their own payroll indicated that processing their own payroll will place a financial burden on their operations. Two of the district superintendents estimated that they had already spent between \$225,000 and \$275,000 on computer equipment and that they will incur additional costs to operate their systems.

CONCLUSION

The Alameda County Superintendent of Schools has made progress toward its goal of achieving financial stability although it is too soon to predict when the ACSS will reach that goal. The ACSS ended 1983-84 with an estimated \$1.6 million deficit fund balance (excluding the \$5.5 million liability for the state loan). However, the ACSS' budget for 1984-85 proposes repaying a significant portion of the loan as well as ending the year with a \$537,000 reserve for contingencies.

The ACSS was able to present a more favorable budget for 1984-85 primarily because of three reasons. First, the ACSS will be reimbursed in 1984-85 for the costs of providing countywide transportation services for the handicapped in

1983-84; because this program was returned to the school districts on July 1, 1984, the ACSS will incur no further costs. According to the terms of the loan that the ACSS received from the State, 92.08 percent of this reimbursement for transportation services will be used to repay the loan. Second, the ACSS will have approximately \$755,000 more than it originally anticipated for 1984-85, and it will be relieved of approximately \$429,000 in interest expense that it would have had to pay in the future because of the way in which representatives of the Superintendent of Public Instruction interpreted certain provisions of Chapter 46, Statutes of 1984, pertaining to the manner in which loan payments are computed in 1984-85 and the manner in which interest expense is charged on the loan. We are concerned about the validity of the representatives' interpretations. Finally, the ACSS has made major changes in its operations, including significantly reducing staff and charging additional fees for services that it previously provided to school districts at lower or no cost.

Despite reductions in staff and operating expenses, the ACSS anticipates being able to continue providing many of the services that it provided in the past. The ACSS expects to make only minimal changes in instructional services, but it does anticipate reductions, delays, and eliminations in support services provided to school districts. The ACSS' lack

of clarity regarding its intention to continue providing payroll data processing services has caused at least eight school districts currently in the ACSS' payroll system to look elsewhere for these services. In fact, some school districts have purchased their own computer equipment, and three district superintendents stated that this action has placed a financial burden on their operations.

The trustee, appointed by the Superintendent of Public Instruction to oversee financial operations at the ACSS, was instrumental in ensuring that a budget reflecting necessary reductions was prepared for 1984-85. To ensure that the required actions took place, the trustee determined that it was necessary to expand his duties beyond the oversight role described in Chapter 46, Statutes of 1984, and he took a more active role in ACSS management.

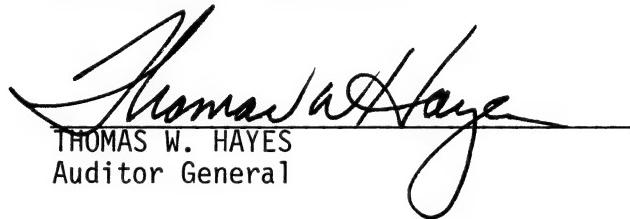
RECOMMENDATIONS

To ensure that the fiscal problems previously experienced at the Alameda County Superintendent of Schools continue to be adequately addressed and that the problems do not recur, the Superintendent of Public Instruction should continue monitoring the ACSS' operations. The Superintendent of Public Instruction should continue to ensure that the ACSS exercises fiscal restraint.

Additionally, the Superintendent of Public Instruction should request an opinion from the Attorney General regarding the legality of the three interpretations relating to the loan from the State.

We conducted this review under the authority vested in the Auditor General by Section 10500 et seq. of the California Government Code. We limited our review to those areas specified in the scope section of this report.

Respectfully submitted,



THOMAS W. HAYES
Auditor General

Date: September 28, 1984

Staff: Curt Davis, CPA, Audit Manager
Karen L. McKenna, CPA
Lois E. Benson, CPA



CALIFORNIA STATE DEPARTMENT OF EDUCATION

721 Capitol Mall
Sacramento, CA 95814

Bill Honig

Superintendent

of Public Instruction

September 26, 1984

Thomas Hayes
Auditor General
660 J Street, Suite 300
Sacramento, CA 95814

Dear Mr. Hayes:

Attached are the Department of Education's comments to your draft report entitled "Status Report: The State Loan to the Alameda County Superintendent of Schools."

The report was received on Thursday, September 20 with a requested response date of the following Wednesday, September 26. While the response time was fairly short, we nonetheless appreciate the opportunity to provide comments to your draft report.

If you have any questions regarding this issue, please contact Robert W. Lawrence, Deputy Superintendent for Field Services, 324-5923.

Sincerely,

A handwritten signature in black ink, appearing to read "William D. Dawson".

William D. Dawson
Executive Deputy Superintendent

Attach.

Page 11

"The Superintendent of Public Instruction did not report to the Legislature the ACSS' failure to prepare an analysis of the county's special (education) transportation program."

Comment: The reasons for not submitting the report are specified in the first paragraph of the report on page 11. In addition, the enabling legislation, AB 247 (Chapter 46) became law on March 21, 1984. The trustee was hired on March 27, 1984. There was not adequate time for the ACSS to prepare the analysis for submission by April 1. Furthermore, a comparable study was conducted in 1981 at a cost of \$120,000. Excerpts of the study were made available to the Auditor General.

It should also be noted that AB 247 directed the county to cease county-wide special education transportation. The Trustee recommended, and the State Department of Education agreed that it would not be good public policy to spend another \$120,000 on a new analysis of the county's special education transportation program that AB 247 had directed be discontinued. Both parties agreed that the requirement to prepare an analysis of the county's special education transportation program and the directive to discontinue that same program were in contradiction to one another.

Page 16

"...The trustee authorized the disbursement of \$84,500..."

Comment: The disbursements were utilized for the following:

1. Provide needed teacher at Juvenile Court School due to increased enrollment (\$26,190) and a second custodian at this school complex (\$19,531)
2. Increase the maintenance budget by \$6,000.
3. Return curriculum specialist to a work year of 209 days from 180 days to enhance educational services (\$32,281)

These were determined by the Trustee to be necessary and appropriate expenditures.

Page 31

"Additionally, the Superintendent of Public Instruction should request an opinion from the Attorney General regarding the legality of the three interpretations relating to the loan from the State."

Comment: As implied on pages 17-20 of the Auditor General's report, interpretation of the statute regarding the loan repayment is a complex issue. Although we believe the issue can be resolved through discussions with the Department of Education and the Auditor General's Office, we will go along with the suggestion that we request an opinion from the Attorney General.



OFFICE OF THE ALAMEDA COUNTY SUPERINTENDENT OF SCHOOLS

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BUSINESS SERVICES

September 24, 1984

Thomas W. Hayes, Auditor General
State of California
660 J Street, Suite 300
Sacramento, CA 95814

SUBJECT: Response to the September 1984 Draft - "Status Report: The State
Loan to the Alameda County Superintendent of Schools"

Dear Mr. Hayes:

I have had an opportunity to review the draft of the "Status Report: The State Loan to the Alameda County Superintendent of Schools" with members of your staff. The following are my comments:

Page 24, Paragraph 2

The Alameda County Superintendent of Schools (ACSS) has reduced significantly the staff at both the Juvenile Court School and Special Centers. At the Juvenile Court School the adopted budget called for the reduction of three assistant directors, two fewer teachers that were employed during 1983-84, and a reduction in the custodial staff. At the Special Centers, the consolidation and reduction in numbers of classes provided for a reduction in professional teaching staff and aides. Additionally, all aides working in the program were reduced in the number of hours served daily.

Page 27, Paragraph 1

The ACSS is no longer negotiating to purchase new computer equipment to provide for data processing services. A study of the options open to the ACSS has concluded that the existing equipment shall be used through FY 85 and into the foreseeable future.

Page 27, Paragraph 2

The ACSS informed district superintendents verbally at a meeting on September 14 that the Office would continue its data processing services with the exception of providing the pupil services package. A written statement to that effect was subsequently forwarded to all district superintendents with the concurrence of the Trustee.

Page 29, Paragraph 2

It must be noted that there are several significant services that will not be provided by the Office as in the past. Services by the Credentials Office have been significantly curtailed. Formerly that office was served by three trained individuals. At present only one clerk remains to respond to querries and to provide support to teachers regarding credentials. The instructional services effort of the Office (Educational Development Services) has reduced significantly its ability to work with local school districts and their efforts to improve instruction. The adopted budget calls for a 37.8% reduction in professional "person days." Subsequent revision of the budget has been recommended and approved to increase the number of professional days available. The new level of staffing provides for a 27.2% reduction in staff over the FY 84 level.

Page 16, Paragraph 1

See Trustee's account of \$84,500.

Page 17, Item 4

The statement that "ACSS would not negotiate salary or benefit increases ..." was not generated by ACSS. Board Memoranda No. 1094 and No. 2005, dated June 27 and August 21 respectively, simply stated that budgets projected on those dates contained no allowances for increases. (Copies are attached.) (*)

Very cordially,

William Berck
Superintendent

WB:jv
Attachments

Auditor General Comment:

(*) Wording changed in report.

OFFICE OF THE ALAMEDA COUNTY SUPERINTENDENT OF SCHOOLS
313 West Winton Avenue, Hayward, CA 94544

June 27, 1984

MEMORANDUM NO. 1094

To: Members of the Alameda County Board of Education
From: Raul Jaramillo, Acting Superintendent
Re: 1984-85 Alameda County Superintendent's Preliminary Budget (CSSF)

Attached is a copy of our preliminary CSSF budget for 1984-85.

Budget development for the County Superintendent's Office requires that the following procedures and timelines be followed:

1. Preliminary Budget must be submitted to Sacramento on or before June 30, 1984.
2. The Public Hearings are scheduled for September 4.
3. Final Budget Adoption must be submitted to Sacramento on or before September 7 of the year it covers.

Because of Final Budget Adoption due on September 7, 1984, the Office is provided additional time with which to remediate budget concerns that exist. The additional time will also allow for conclusions of legislative action that will definitely influence the final budget.

All salary estimates are based upon current employees unit contracts or memorandums of understanding. No allowances have been made for increases in employee salaries or benefits beyond what is provided in current contracts or memorandums of understanding.

Dr. Charles Kenney will review with the Board in detail the attached 1984-85 budget and plans developed in cooperation by Dr. Charles Kenney and this Office to achieve a balanced budget.

Approval of the preliminary budget for 1984-85 is requested at this meeting.

OFFICE OF THE ALAMEDA COUNTY SUPERINTENDENT OF SCHOOLS

William Berck, Superintendent

August 21, 1984

MEMORANDUM NO. 2005

To: Members of the Alameda County Board of Education
From: William Berck, Secretary
Re: 1984-85 Alameda County Superintendent's Proposed Final Budget (CSSF)

Attached is a copy of our proposed final CSSF budget for 1984-85. Final budget adoption must be submitted to Sacramento on or before September 7, 1984, and a Board meeting to comply with this task is scheduled for September 4, 1984.

All salary estimates are based upon current employees unit contracts or memorandums of understanding. No allowances have been made for increases in employee salaries or benefits beyond what is provided in current contracts or memorandums of understanding. A contingency fund of \$351,388. is included in this budget.

The remaining process to be completed, which will finalize the 1984-85 budget, is the closing of the 1983-84 budget accounts. This task will be completed on Wednesday, August 22, 1984. A copy of the final budget (including the 1983-84 closing accounts) will be forwarded to you by or before August 27, 1984, with the understanding that adjustments may occur up until September 4, 1984.

The Board may wish to schedule appointments with me either individually or as a subcommittee to review this final document.

WB:rj
attach.

cc: Members of the Legislature
Office of the Governor
Office of the Lieutenant Governor
State Controller
Legislative Analyst
Assembly Office of Research
Senate Office of Research
Assembly Majority/Minority Consultants
Senate Majority/Minority Consultants
Capitol Press Corps